

## Organic Market Overview and Considerations

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### Market Summary

Organic agriculture has grown to be a worldwide multi-billion dollar industry over the past dozen years, with global sales estimated at \$38.6 billion in 2008. While US market-share is between 1-2%, this market niche is widely regarded as profitable and rapidly growing. This growth has been almost entirely consumer-driven. Most organic crops command a higher price than comparable conventional food; the premium varies according to the commodity and market conditions. Consumers are willing to pay more for organic food based on a number of preferences not clearly understood or commonly agreed-upon by market researchers.

Organic agriculture differs from conventional agriculture not just based on production, but also in how it is marketed and what it means to consumers. Successful marketing of organic crops requires planning and advance work in gauging demand, finding gaps in supply, and discovering the channels needed to reach the consumer. Marketing information tools available include finding local farmers markets and accessing directories of buyers. Agricultural professionals consulting for larger operations will often need to help meet a production schedule and delivery date. Long-term market sustainability relies on meeting consumer expectations.

While academic researchers have focused on the perceived food safety and health benefits of organic food, industry analysts have found that organic consumers have distinct preferences for the flavor, texture, and overall quality of organic food. Consumers will also cite altruistic reasons to purchase organic food. The altruistic reason most often cited is environmental protection, but consumers will also give animal welfare and social concerns as reasons that they provide economic support to organic farmers. Avoidance of pesticides, genetic engineering, antibiotics, sewage sludge, feeding animal by-products to livestock, and irradiated food are not as easily compartmentalized as food safety and health benefits, animal welfare, or environmental concerns. Consumers who question various agricultural technologies for a variety of reasons purchase organic food as an alternative.

### Demographics

The 'typical' organic consumer defies easy characterization. Most consumers who buy organic products still purchase more non-organic products. Several surveys provide data that supports that most consumers know about organic food and buy it when it is available. However, the number of consumers who buy mostly organic food is small and those who buy organic food exclusively is even smaller. Market analysts have conducted follow-up studies to look at actual purchases in addition to consumer surveys and find that consumers will make choices that appear to be inconsistent with food safety or health concerns.

Income is a factor. Below a certain income, consumers have a diminished ability to pay a premium for organic food, even if they are aware of and desire the benefits. However, beyond that threshold, income ceases to be a determining factor. Households that have income in the top 20% are no more likely to purchase organic food than those households that fall in the middle 40% income bracket. Education is more strongly correlated than income, with college-educated individuals more likely to purchase organic food than those whose education was completed at the high school level. Women are also more likely to buy organic food than men.

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Sales have been growing in the double-digits over the past decade. In 2009, US sales slowed to single-digit growth (5%), indicating market resilience, albeit not immunity, from the economic recession. Despite the small market share, the United States is now the largest market for organic food in the world eclipsing Germany, the previous leader. Even though organic food has a greater market share in Germany, the US is a much bigger market. California is the state that both produces and consumes the greatest amount of organic food of any state in the US. The San Francisco Bay and the Los Angeles areas are both among the largest markets in the US for organic food. In the Pacific Northwest, Portland and Seattle are also significant organic food markets. In general, organic food tends to be sold in large metropolitan areas, college towns, and affluent suburbs. Demand is identified as strong by the USDA's Economic Research Service (ERS) in several Northeast cities and is growing in the Midwest. Organic food sales in the US have their smallest share in the Southern states, although there are some metropolitan areas in Florida, Texas and North Carolina that are also strong markets.

### **Market Segments**

Fresh fruits and vegetables have long been the largest market segment. Consumer surveys reveal that consumers make their first conscious decision to purchase organic produce. Fresh fruits and vegetables are consistently the most often purchased organic products. Organic baby food sales remain strong. Market studies show that consumers are willing to pay a much greater premium for food primarily consumed by infants and young children rather than for adults or older children. Milk, meat, and cereal products are seen as gateway product categories and continue to grow. Consumers expect and demand that anything available in conventional form also be made available from organic sources as well.

### **Marketing Channels**

Historically, most organic food was sold through natural food stores and cooperatives. Organic food is increasingly distributed through mainstream channels to the point where the majority of organic food is now sold through large supermarkets. Within the retail sector, some of the more rapidly growing chains have been stores that prominently feature organic food. Organic farmers have also relied heavily on direct marketing, particularly those that do not produce a volume sufficient for consistent supply to retailers. Most successful small- to medium-sized organic farmers will rely on a diverse number of marketing channels rather than relying on a single buyer. Organic farmers use farmers markets, on-farm sales, subscription or community supported agriculture (CSA) shares, and restaurant accounts in preference to wholesale as marketing outlets. Retail and wholesale distributors will often be used as outlet channels when available.

Large organic farms tend to rely on advance contracts with processors and high volume retail sales. The largest fresh produce farms are vertically integrated as packer-shippers, paralleling the conventional channels for distribution. Packer-shipper operations will contract with producers, particularly in cases where the producers can fill different market windows. With a growing number of organic food processors entering the market, an increased volume of purchases go through contracted channels. Spot market sales and terminal markets have been the least profitable outlets for organic farmers. With rare exceptions, these markets will not pay a premium for organic product. Buyers willing to pay an organic premium often have a lower *Red Book* or *Blue Book* credit rating than the industry average because they are relatively new and have low capitalization in contrast to older, more established creditors with more conservative purchasing rules.

Studies note the high volatility of the organic market. Given the relatively short history, rapid growth, and relative size of the organic market, such volatility is to be expected. However, professionals working in this field should be aware that price premiums are not necessarily well-behaved or predictable. Contract production may reduce some of that volatility at the cost of losing high-end premiums.

### **Export Markets**

Organic food is also purchased throughout the world. Outside of the United States, Germany and the United Kingdom are the two next largest markets. The entire European Union (EU) has sales that are approximately equivalent to those in the US, particularly when the new and incoming members are included. Canada is a major destination for exported US organic product with organic food sales of over \$2 billion in 2008, of which about 80% is imported. The US has established an equivalency agreement with Canada that recognizes organic products produced and handled under the USDA National Organic Program (NOP) as meeting Canadian organic standards, with some specific exceptions.

The EU updated its regulations in 2007 [EC 834/2007] and 2008 [EC889/2008] replacing a regulation established in 1991 [EC 2092/91]. One of the reasons for the new regulation was to harmonize European standards both within the EU among member states and with third-country trading partners.

Japan is the largest market for organic food outside of Europe and North America. The NOP was recognized as equivalent to the Japan Agricultural Standard (JAS) for organic food, again with a few exceptions. Consumer demand is still strong, but Japanese consumers have a strong loyalty to domestic producers and the US faces stiff competition for the Japanese market from China, Australia, and Brazil.

While export markets offer a number of profitable opportunities for producers, they also present additional risks and challenges. Many export market risks are inherent to international trade and not limited to the organic sector. All EU countries have adopted at least some fiscal policies that favor organic farming over conventional and subsidize conversion to organic production methods. Such subsidies are generally considered legal under the General Agreement on Tariffs and Trade (GATT). US production costs are still competitive and because of strong consumer support, organic price premiums in many of these markets will exceed those in the US. Also, a number of developing countries will have low wage structures and relatively high input costs. Countries such as Mexico and China have export-oriented organic production to produce a crop mix that competes directly with US producers.

Trade disputes under GATT are adjudicated by the World Trade Organization (WTO). The WTO refers to Codex Alimentarius in cases of differences in standards between member states. Codex Alimentarius has established a set of international guidelines for organic agriculture [CAC 32/1999] which, although non-binding, are expected to be used in case a country's exports are denied access to a market and the exporter believes the difference in standards forms a technical barrier to trade. The growth and globalization of the market for organic agricultural commodities is expected to require continuous work on improvement and harmonization of the standards.